

UNITED STATES DISTRICT COURT  
DISTRICT OF NEVADA

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USF INSURANCE COMPANY, a Michigan  
corporation,

Plaintiff,

v.

SMITH'S FOOD AND DRUG CENTER,  
INC.; d/b/a SMITH'S FOOD AND DRUG  
CENTER, #377, an Ohio corporation, and  
J&I MAINTENANCE, a Utah corporation,

Defendants.

Case No. 2:10-cv-01513-MMD-VCF

ORDER

SMITH'S FOOD AND DRUG CENTER,  
INC. d/b/a SMITH'S FOOD AND DRUG  
CENTER, #377, an Ohio corporation,

Counterclaimant,

v.

USF INSURANCE COMPANY, a  
Michigan corporation; and ROE  
CORPORATIONS I-X, inclusive,

Counterdefendants.

**I. SUMMARY**

Before the Court are three competing summary judgment motions filed by Plaintiff USF Insurance Company ("USF") and Defendant Smith's Food & Drug Centers, Inc. ("Smith's"). (Dkt. nos. 61, 63, and 84.) At stake is the resolution of USF's claims and Smith's' counterclaims arising out of an insurance dispute. The Court has reviewed the

1 briefings in these motions, and makes its rulings in accordance with the reasoning set  
2 forth below.

## 3 **II. BACKGROUND**

### 4 **A. The Insurance Contracts**

5 J&I Maintenance (“J&I”) is in the business of providing janitorial and cleaning  
6 services to its clients. On January 19, 2004, Smith’s, a national grocery store operator,  
7 entered into a one-year Maintenance Agreement (“Agreement”) in which J&I agreed to  
8 perform daily cleaning and maintenance at various Smith’s stores. The Agreement  
9 obligated J&I to defend, indemnify, and hold Smith’s harmless from all claims, losses,  
10 expenses, and liability resulting from J&I’s cleaning and maintenance. The Agreement  
11 also required J&I to maintain comprehensive liability insurance with a minimum  
12 aggregate coverage of \$2,000,000 under which Smith’s was to be designated as an  
13 additional named insured.

14 J&I was insured under a comprehensive commercial general liability policy (“the  
15 Policy”) through USF with a general aggregate liability limit of \$2,000,000 and a personal  
16 injury limit of \$1,000,000. USF agreed to defend and indemnify J&I against all claims of  
17 bodily injury that J&I becomes legally obligated to pay. The Policy also stated that USF  
18 agreed to defend and indemnify all “additional insureds.”

19 On May 25, 2006, Smith’s and J&I extended the terms of the Agreement for an  
20 additional year.

### 21 **B. The Bell Litigation**

22 In February 2007, Tammy Bell filed suit against Smith’s and J&I for injuries  
23 resulting from an alleged slip and fall that occurred at a Smith’s location. On February  
24 26, 2008, Smith’s’ counsel, Mr. Jerry Busby, tendered the defense of the Bell litigation to  
25 J&I and demanded that Smith’s be defended and indemnified from all liability pursuant to  
26 the Agreement. (Dkt. no. 61-B.) USF alleges that J&I never accepted the tender.  
27 Instead, the attorney USF had authorized to represent J&I, John Shannon,  
28 misrepresented to USF that J&I did in fact accept Smith’s’ tender. USF alleges that as a

1 result of this misrepresentation, USF authorized Mr. Shannon to also defend Smith's in  
2 the action on July 15, 2008. (Dkt. no. 68-E.)

3 On July 2, 2008, Mr. Shannon sent USF an initial suit report detailing the facts of  
4 the case, his assessment of J&I's liability, and an estimated damages exposure in light  
5 of Ms. Bell's surgery. (Dkt. no. 84-O.) At the time the report was prepared, Ms. Bell's  
6 deposition had not been taken, and various medical records relating to an upcoming  
7 spinal fusion surgery as well as earlier medical procedures pre-dating the accident were  
8 unavailable. Nevertheless, Mr. Shannon assessed J&I's liability at 100% based on the  
9 testimony of various witnesses. Mr. Shannon noted that he could not assess J&I's  
10 potential exposure in light of the missing medical evidence, but approximated it to be  
11 roughly \$200,000.

12 Smith's alleges that Mr. Shannon took Ms. Bell's deposition on September 18,  
13 2008, where he learned that Ms. Bell had undergone a failed back fusion surgery before  
14 her deposition. Smith's alleges that it was never informed of Bell's deposition or alleged  
15 injuries, or that her medical bills had risen to over \$200,000.

16 On November 24, 2008, Ms. Bell's counsel served an Offer of Judgment seeking  
17 to settle the litigation for \$999,999.99 ("the Offer"). (Dkt. no. 68-F.) Smith's alleges that it  
18 was not apprised of this offer during the acceptance period. Having received no  
19 response from J&I, Ms. Bell's counsel wrote Mr. Busby on December 17, 2008,  
20 extending the deadline to respond to the Offer and noting that J&I's failure to respond  
21 may constitute bad faith on the part of J&I's insurer. (Dkt. no. 68-G.) In the meantime,  
22 and after having received the Offer which USF had rejected, Mr. Shannon wrote to USF  
23 on December 22, 2008, recommending that USF revisit its previous denial of the Offer  
24 and to accept Ms. Bell's Offer in light of the documented medical damages suffered by  
25 Ms. Bell. (Dkt. no. 68-I.)

26 Having not received a response to the Offer or a response to a phone call, Ms.  
27 Bell's counsel wrote to Mr. Shannon on December 29, 2008, to extend the deadline for  
28 J&I's response to the Offer. (Dkt. no. 68-H.) The offer ultimately lapsed.

1           On April 27, 2009, mediation in the Bell litigation failed to settle the dispute. After  
2 its completion, Mr. Busby wrote Mr. Shannon and J&I on April 29, 2009, on behalf of  
3 Smith's, expressing his disapproval of J&I's failure to settle the litigation. (Dkt. no. 68-J.)  
4 Mr. Busby described the mediation as a failure, and noted his frustration that J&I  
5 countered Ms. Bell's offer of a \$3.75 million settlement with only a \$100,000 offer. In  
6 light of the failure, Mr. Busby concluded that "[t]he decision made by either J&I or their  
7 insurance carrier to risk a verdict over policy limits appears to have been made in bad  
8 faith," and reserved his client's rights to pursue a claim against J&I and USF. (*Id.* at 2.)

9           On November 19, 2009, Mr. Busby wrote Mr. Shannon, USF, and J&I demanding  
10 that USF provide separate counsel for Smith's and that USF settle the litigation above its  
11 policy limits and incur all of the resulting costs. (Dkt. no. 68-K.)

12           In response to the November 19, 2009, letter, Sally Rock, Liability Claims  
13 Examiner for USF, wrote Mr. Busby on December 22, 2009, to explain USF's decision  
14 not to settle. (Dkt. no. 68-L.) She explained that USF's failure to respond to Ms. Bell's  
15 offer was due to not having all of Ms. Bell's medical records to evaluate her claims, and  
16 that USF's failure to resolve the dispute during mediation was due to Ms. Bell's surprise  
17 request for settlement above the policy limit. Ms. Rock concluded the letter by informing  
18 Mr. Busby that USF's duty to defend and indemnify Smith's depends on the terms of  
19 USF's policy with J&I, and that this policy does not permit Smith's to choose its own  
20 counsel. Ms. Rock again refused to appoint independent counsel as documented in a  
21 March 15, 2010, letter. (Dkt. no. 84-M.)

22           On May 7, 2010, Mr. Busby wrote to Ms. Rock concerning Smith's and J&I's  
23 liability in the underlying Bell litigation. (Dkt. no. 6-L.) In this letter, Mr. Busby recounted  
24 a March 25, 2010, status report prepared by Mr. Shannon in which Mr. Shannon noted  
25 that a conflict of interest existed between J&I and Smith's, that sufficient evidence  
26 existed for J&I to be found liable for causing the accident, and that he valued the  
27 exposure in the case to be between \$6 to \$10 million. (*Id.*)

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1           Thereafter, Smith's retained its own counsel to proceed with the Bell litigation. On  
2 August 20, 2012, USF requested Smith's clarify the existence of a current agreement  
3 that addresses the accident at issue in the Bell litigation.

#### 4           **C.     This Lawsuit**

5           USF filed this declaratory judgment action on September 3, 2010, seeking a  
6 declaration that USF was not obligated to represent and indemnify Smith's. On  
7 September 23, 2010, Smith's answered USF's Complaint and brought various  
8 counterclaims against USF. Along with its counterclaims, Smith's disclosed the  
9 confidential report and valuation of the Bell litigation made by USF's retained attorney,  
10 John Shannon, and attached a copy of this report to the pleadings. (See dkt. no. 6-E  
11 and 6-L.) USF alleges that plaintiff's counsel in the Bell litigation read the disclosed  
12 report, which eventually delayed and increased the value of settlement. The Bell  
13 litigation ultimately settled against both J&I and Smith's, with USF agreeing to pay \$1  
14 million on behalf of J&I and Smith's agreeing to pay \$2 million. (Dkt. no. 63-1 at ¶ 11.)

15           USF brings a Motion for Summary Judgment on Smith's counterclaims, as well as  
16 a Motion for Partial Summary Judgment on its declaratory relief causes of action. (Dkt.  
17 nos. 61 and 63.) Smith's opposed these motions, and later filed a competing Motion for  
18 Summary Judgment seeking judgment on its counterclaims. (Dkt. no. 84.)

#### 19           **III.     STANDARD OF REVIEW**

20           The purpose of summary judgment is to avoid unnecessary trials when there is no  
21 dispute as to the facts before the court. *Nw. Motorcycle Ass'n v. U.S. Dep't of Agric.*, 18  
22 F.3d 1468, 1471 (9th Cir. 1994). Summary judgment is appropriate when the pleadings,  
23 the discovery and disclosure materials on file, and any affidavits "show there is no  
24 genuine issue as to any material fact and that the movant is entitled to judgment as a  
25 matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 330 (1986). An issue is "genuine"  
26 if there is a sufficient evidentiary basis on which a reasonable fact-finder could find for  
27 the nonmoving party and a dispute is "material" if it could affect the outcome of the suit  
28 under the governing law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-49 (1986).

1 Where reasonable minds could differ on the material facts at issue, however, summary  
2 judgment is not appropriate. *Warren v. City of Carlsbad*, 58 F.3d 439, 441 (9th Cir.  
3 1995). “The amount of evidence necessary to raise a genuine issue of material fact is  
4 enough ‘to require a jury or judge to resolve the parties’ differing versions of the truth at  
5 trial.” *Aydin Corp. v. Loral Corp.*, 718 F.2d 897, 902 (9th Cir. 1983) (quoting *First Nat’l*  
6 *Bank v. Cities Service Co.*, 391 U.S. 253, 288-89 (1968)). In evaluating a summary  
7 judgment motion, a court views all facts and draws all inferences in the light most  
8 favorable to the nonmoving party. *Kaiser Cement Corp. v. Fishbach & Moore, Inc.*, 793  
9 F.2d 1100, 1103 (9th Cir. 1986).

10 The moving party bears the burden of showing that there are no genuine issues  
11 of material fact. *Zoslaw v. MCA Distrib. Corp.*, 693 F.2d 870, 883 (9th Cir. 1982). “In  
12 order to carry its burden of production, the moving party must either produce evidence  
13 negating an essential element of the nonmoving party’s claim or defense or show that  
14 the nonmoving party does not have enough evidence of an essential element to carry its  
15 ultimate burden of persuasion at trial.” *Nissan Fire & Marine Ins. Co. v. Fritz Cos.*, 210  
16 F.3d 1099, 1102 (9th Cir. 2000). Once the moving party satisfies Rule 56’s  
17 requirements, the burden shifts to the party resisting the motion to “set forth specific  
18 facts showing that there is a genuine issue for trial.” *Anderson*, 477 U.S. at 256. The  
19 nonmoving party “may not rely on denials in the pleadings but must produce specific  
20 evidence, through affidavits or admissible discovery material, to show that the dispute  
21 exists,” *Bhan v. NME Hosps., Inc.*, 929 F.2d 1404, 1409 (9th Cir. 1991), and “must do  
22 more than simply show that there is some metaphysical doubt as to the material facts.”  
23 *Orr v. Bank of Am.*, 285 F.3d 764, 783 (9th Cir. 2002) (internal citations omitted). “The  
24 mere existence of a scintilla of evidence in support of the plaintiff’s position will be  
25 insufficient.” *Anderson*, 477 U.S. at 252.

26 Although motions for partial summary judgment are common, Rule 56 of the  
27 Federal Rules of Civil Procedure, which governs summary judgment, does not contain  
28 an explicit procedure entitled “partial summary judgment.” As with a motion under Rule

56(c), partial summary judgment is proper “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” Fed. R. Civ. P. 56(c).

Further, “when parties submit cross-motions for summary judgment, ‘[e]ach motion must be considered on its own merits.’” *Fair Hous. Council of Riverside Cnty., Inc. v. Riverside Two*, 249 F.3d 1132, 1136 (9th Cir. 2001) (quoting William W. Schwarzer, et al., *The Analysis and Decision of Summary Judgment Motions*, 139 F.R.D. 441, 499 (Feb.1992) (citations omitted). “In fulfilling its duty to review each cross-motion separately, the court must review the evidence submitted in support of each cross-motion.” *Id.*

#### IV. DISCUSSION

USF and Smith’s bring competing motions seeking judgment on USF’s declaratory judgment claim as well as Smith’s’ declaratory relief counterclaim, insurance bad faith counterclaim, equitable estoppel counterclaim, and request for punitive damages. For ease of analysis, the Court will address first the alleged violations of USF’s duties to defend and indemnify Smith’s, then turn to USF’s duty of good faith and fair dealing. This section concludes with an analysis of USF’s affirmative defenses, and Smith’s’ request for punitive damages.<sup>1</sup>

##### A. Duty to Defend and Indemnify

##### 1. Legal Standard

“Nevada has long recognized the special relationship between the insurer and its insured.” *Powers v. United Servs. Auto. Ass’n*, 962 P.2d 596, 700 (Nev. 1998). That relationship is one of “special confidence,” *Ainsworth v. Combined Ins. Co. of Am.*, 763

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<sup>1</sup>In its Reply filed in support of its Motion for Summary Judgment, Smith’s introduced new evidence relating to USF’s Chairman, and made new arguments based on that evidence for the first time. (See dkt. no. 96 at 8-11.) Because Smith’s improperly introduced new evidence in a reply, the Court declines to review this evidence. See *Provenz v. Miller*, 102 F.3d 1478, 1483 (9th Cir. 1996).



1 P.2d 673, 676 (Nev. 1988), and is similar to that between a fiduciary and a client, see  
 2 *Powers*, 962 P.2d at 701. The Nevada Supreme Court has recognized that an insurer  
 3 owes a duty of good faith and fair dealing to its insured, in addition to a fiduciary-like  
 4 responsibility that is “part of the duty of good faith and fair dealing.” *Id.*

5 Among the obligations of an insurer to its insured are the duty to defend and the  
 6 duty to indemnify. *Miller*, 212 P.3d at 324. The duty to defend is broader than the duty to  
 7 indemnify, since indemnification requires that the insured’s actions and resulting loss  
 8 actually fall within the policy’s coverage while the duty to defend is triggered when the  
 9 insured’s actions and loss are *potentially* within the policy’s coverage. *Id.*; see *United*  
 10 *Nat’l Ins. Co. v. Frontier Ins. Co., Inc.*, 99 P.3d 1153, 1158 (Nev. 2004) (noting that while  
 11 “[t]here is no duty to defend where there is no potential for coverage,” an insurer must  
 12 defend the insured where there is a potential of liability under the policy). “If there is any  
 13 doubt about where the duty to defend arises, this doubt must be resolved in favor of the  
 14 insured.” *Id.* (citing *Aetna Cas. & Sur. Co. v. Centennial Ins. Co.*, 838 F.2d 346, 350 (9th  
 15 Cir.1988)).

16 The duty to defend in turn creates a duty of good faith and fair dealing during  
 17 negotiations, since the insurer has a right to control the settlement discussions. *Miller*,  
 18 212 P.3d 318, 324-25. Likewise, the insurer’s right to control litigation creates a duty to  
 19 defend the insured from lawsuits within the insurance policy’s coverage. *Id.* at 325.

## 20 **2. Analysis**

21 USF violated its duty to defend and indemnify Smith’s, even though USF entered  
 22 into an insurance contract only with J&I. To begin with, J&I and Smith’s entered into a  
 23 Maintenance Agreement wherein J&I agreed to “defend, indemnify, and hold [Smith’s]  
 24 . . . harmless from all claims, demands, losses, expenses and liability . . . for any bodily  
 25 injury, sickness, disease, death, or damage to or destruction of property . . . arising out  
 26 of or resulting from the performance of [J&I’s] work or any of its employees or  
 27 subcontractors, even if the loss was partially caused by the negligence of [Smith’s].”

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(Dkt. no. 68-B at ¶ 8.) The Agreement did not require that J&I formally accept Smith's tender of any liability; this obligation flowed automatically from the Agreement.

Based on the indemnification clause in the Maintenance Agreement, the terms of the Policy required USF to indemnify Smith's. Specifically, the Policy provided that USF "will pay those sums that the insured [J&I] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damages' to which this insurance applies" and that USF "will have the right and duty to defend the insured against any 'suit' seeking those damages." (Dkt. no. 84-C at 40.) The Policy also applied to liability assumed in an "insured contract" entered into by J&I to assume a third party's liability for bodily injury. (*Id.* at 41.) The Policy defined an "insured contract" as including "[t]hat part of any other contract or agreement pertaining to your business . . . under which you assume the tort liability of another party to pay for 'bodily injury' or 'property damage' to a third person or organization." (*Id.* at 52.) Based on the plain language of the Policy, the Maintenance Agreement qualified as an "insured contract" because it required J&I to assume Smith's tort liability. See *McDaniel v. Sierra Health and Life Ins. Co., Inc.*, 53 P.3d 904, 906 (Nev. 2002) (noting that insurance policies are to be construed "from the viewpoint of one not trained in law or insurance, giving the terms their plain, ordinary, and popular meaning"). Consequently, the Policy covered liability assumed by J&I through the Maintenance Agreement. As a result, Smith's has standing to pursue claims premised on USF's duty to defend and indemnify, even though Smith's lacked an express contractual relationship with USF. See *Bergerud v. Progressive Cas. Ins.*, 453 F. Supp. 2d 1241, 1249 (D. Nev. 2006) ("When an insurer defines a non-contracting party as 'insured,' it makes a contractual agreement to offer benefits to each person fitting within that definition.").<sup>2</sup>

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<sup>2</sup>USF cites *Insurance Co. of North America v. Hilton Hotels USA, Inc.*, 908 F. Supp. 809, 814 n.2 (D. Nev. 1995) for the proposition that an insurer is under no obligation to defend an entity not an insured under the insurer's policy. This rule is inapplicable here, since the Policy designates Smith's as an insured. As a result, USF owes a duty to defend its insured in an action against the insured. See *Rockwood Ins. Co. v. Federated Capital Corp.*, 694 F. Supp. 772, 776 (D. Nev. 1988) ("The insurer must (*fn. cont...*)

1           The supplemental payments provision in the Policy also required that USF defend  
 2 Smith's. It provided that "[i]f we defend an insured against a 'suit' and an indemnitee of  
 3 the insured is also named as party to the 'suit', we will defend that indemnitee" if a  
 4 number of conditions are met. (Dkt. no. 84-C at 47.) These conditions included that the  
 5 suit against the indemnitee seeks damages for which the insured has assumed liability  
 6 under an 'insured contract'; the Policy covers the suit; the obligation to defend the  
 7 indemnitee is included in the 'insured contract'; the allegations in the 'suit' are such that  
 8 no conflict appears to exist between the insured and the indemnitee; the insured and the  
 9 indemnity ask USF to control the defense of the suit; the same counsel represents both  
 10 the insured and the indemnitee; and that written authorization of USF's representation is  
 11 provided to USF. (*Id.*) J&I's contractual agreement to indemnify Smith's for damages in  
 12 the Bell litigation triggered USF's obligation to defend Smith's as an indemnitee of J&I.  
 13 Indeed, in her deposition, Ms. Rock admitted the conditions required to trigger USF's  
 14 representation of Smith's as an indemnitee existed during the life of the representation.<sup>3</sup>  
 15 (Dkt. no. 73-O at 132:13-22.) That J&I did not formally agree to defend and indemnify  
 16 Smith's is irrelevant to whether these duties attached to USF, since the Maintenance  
 17 Agreement *required* J&I to defend and indemnify Smith's. USF's citation to *York*  
 18 *International Group v. Cincinnati Ins. Co.*, No. 06-4778, 2007 WL 2667984, at \*7-8 (E.D.  
 19 Pa. Sep. 5, 2007), which held that an insurance contract does not confer third-party  
 20 beneficiary status to contractual indemnitees, is inapposite. *York International* relied

21 

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 (fn. cont.)

22 defend any lawsuit brought against its insured which potentially seeks damages within  
 the coverage of the policy.").

23           <sup>3</sup>Notwithstanding the admission of its claims officer, USF erroneously argues that  
 24 Smith's' demand for separate counsel destroyed the conditions for USF's representation  
 25 of Smith's. First, the Policy designated Smith's as an insured regardless of the  
 26 supplementary payments section. Second, USF may have been under an obligation to  
 27 provide its insured with independent counsel when a conflict with Smith's arose. See  
 28 *Hansen v. State Farm Mut. Auto Ins. Co.*, No. 2:10-cv-1434-MMD-RJJ, 2012 WL  
 6205722, at \*8-9 (D. Nev. Dec. 12, 2012) (interpreting Nevada law to adopt requirement  
 that insurers must provide independent counsel to insureds when conflict arises, per *San*  
*Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 162 Cal. App. 3d 358, 364  
 (1984)).

1 both on contrary state law inapplicable to this Nevada litigation as well as the simple fact  
2 that the third parties were held not to be additional insureds under the policy at issue.

3 In addition to — and because of — the terms of the Policy requiring USF to insure  
4 Smith's, USF defended Smith's in the Bell litigation. Even independent of Smith's' status  
5 as an additional insured under the Policy, once USF assumed the defense, it established  
6 a contractual relationship that obligated it to act in good faith and deal fairly with Smith's.  
7 *See United Nat'l Ins. Co. v. Frontier Ins. Co.*, 99 P.3d 1153, 1158 (Nev. 2004) (noting  
8 that once the duty to defend arises, the insurer's duty continues throughout the entire  
9 litigation). Indeed, USF acted as an insurer of Smith's by asserting the right to defend  
10 Smith's during settlement negotiations, making an offer on Smith's behalf during those  
11 negotiations, referring to Smith's as an insured in numerous communications, and  
12 refusing Smith's' demand for separate counsel when conflicts arose.

13 Lastly, USF did not accept Smith's defense with a reservation of rights. It did not  
14 challenge J&I's obligation to defend Smith's, and did not reserve the right to recover from  
15 Smith's should it later determine that it was under no obligation to enter into the  
16 representation. Although USF may have accepted J&I's defense with a reservation of  
17 rights, that fact does not have any bearing on its independent representation of Smith's.  
18 Consequently, Smith's has standing to assert waiver because of its status as USF's  
19 insured. Indeed, numerous references in the record demonstrate USF's characterization  
20 of Smith's as an "additional insured." That USF did not reserve its right to challenge its  
21 obligation to defend Smith's provides additional support for the Court's decision.

22 Indeed, a perverse result would follow from the Court holding otherwise. USF  
23 seeks a rule that allows an insurer to extricate itself from representing a third party after  
24 it incorrectly assumed that it was under an obligation to do so, even when the insurer did  
25 not reserve its rights. In effect, USF's rule places the burden on the third party  
26 beneficiary to interpret the insurer's actions and the insurer's policy in order to assure  
27 itself that the insurer will not abandon its duties mid-course. The more reasonable rule —  
28 and the rule most in line with Nevada law — would require the insurer to carry the burden

1 of determining whether the underlying facts exist for it to assume the duty to represent a  
2 third party. USF's rule would abdicate an insurer's responsibility of due diligence, and  
3 would saddle clients represented with counsel retained by insurance companies with  
4 unnecessary uncertainty. Contrary to USF's position, the law is not so forgiving.

5 Smith's has demonstrated as a matter of law that USF had a duty to defend and  
6 indemnify Smith's in the Bell litigation, and succeeds in its request for declaratory  
7 judgment accordingly.

8 **B. Bad Faith Insurance Claim**

9 **1. Legal Standard**

10 An insurer's bad faith in handling a claim against an insured is actionable as a  
11 breach of the implied covenant of good faith and fair dealing between the insurer and the  
12 insured. "Where an insurer fails to deal fairly and in good faith with its insured by  
13 refusing without proper cause to compensate its insured for a loss covered by the policy  
14 such conduct may give rise to a cause of action in tort for breach of an implied covenant  
15 of good faith and fair dealing." *U.S. Fidelity & Guar. Co. v. Peterson*, 540 P.2d 1070,  
16 1071 (Nev. 1975). Put differently, bad faith exists where there is an "actual or implied  
17 awareness of the absence of a reasonable basis for denying benefits of the insurance  
18 policy." *Allstate Ins. Co. v. Miller*, 212 P.3d 318, 324 (Nev. 2009) (quoting *Am. Excess*  
19 *Ins. Co. v. MGM*, 729 P.2d 1352, 1354-55 (Nev. 1986)). Poor judgment or negligence  
20 on the part of an insurer does not amount to bad faith. *Guebara v. Allstate Ins. Co.*, 237  
21 F.3d 987, 995 (9th Cir. 2001) (stating California law). This duty of good faith arises by  
22 law irrespective of the insurance contract's terms, and flows from Nevada law's  
23 recognition of an implied covenant of good faith and fair dealing in every contract. *Id.*;  
24 see *Pemberton v. Farmers Ins. Exch.*, 858 P.2d 380, 382 (Nev. 1993). The existence of  
25 an insurer's bad faith is a matter of fact to be decided by the jury. *Allstate Ins. Co.*, 212  
26 P.3d at 327 (citing with approval *Allen v. Allstate Ins. Co.*, 656 F.2d 487, 489 (9th Cir.  
27 1981) (discussing California law)).

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## 2. Analysis

A genuine issue of material facts exists as to whether USF failed to act in good faith toward its client, Smith's. Upon initiating its representation of Smith's, USF failed to respond to settlement offers from Ms. Bell's counsel in November and December 2008. This failure to respond disturbed both Smith's counsel and USF's retained attorney, both of whom urged USF to accept the offer. USF refused, and proceeded to reject settlement offers within policy limits during the period between 2008 and 2011.

Smith's argues that USF's failure to accept the Offer constituted bad faith in light of Mr. Busby's and Mr. Shannon's recommendations to do so. Smith's has not demonstrated as a matter of law that USF acted against clear evidence demonstrating both Smith's and J&I's liability as well as evidence supporting a higher damages valuation. In his July 2, 2008, letter, Mr. Shannon determined that J&I was solely responsible for Ms. Bell's injuries, but refused to conclusively provide a figure for her damages. As of December 22, 2008, Mr. Shannon determined that the potential for damages exposure favored accepting the Offer. (Dkt. no. 68-I.) This determination was based on new records revealed since the July 2 report.

In a November 2009 letter, USF justified its decision not to accept the Offer and to offer only \$100,000 during mediation by claiming that it had not received all of the relevant medical information, that its retained expert expressed doubt as to the cause of Ms. Bell's medical damages, and that Ms. Bell might be exaggerating her claims during the litigation. (Dkt. no. 68-L.) This response raises questions as to whether USF acted appropriately, questions that the Court is unwilling to rule on as a matter of law. Although USF should have recognized that J&I was solely responsible for Ms. Bell's injuries, an issue of fact remains as to whether it was reasonable for USF to reject the Offer and only offer \$100,000 to settle the claim. Since Mr. Shannon appears not to have conclusively determined whether or not Ms. Bell's medical damages were related to any preexisting conditions, and since USF relied on the opinion of an expert who questioned the cause of Ms. Bell's expenses, USF has raised triable issue of fact. It is

1 the province of the jury, not the Court, to weigh the credibility and value of the  
2 information available to USF during this period. See *Allen*, 656 F.2d at 489 (noting that  
3 because what is good faith and bad faith “has not yet proved susceptible to pat legal  
4 definition, an insurer’s ‘good faith’ is essentially a matter of fact.”).

5 The Court notes that Mr. Shannon’s March 2010 evaluation of liability and \$6 to  
6 \$10 million valuation of damages does not conclusively establish USF’s bad faith in the  
7 period between December 2008 and April 2009. This evaluation of both damages and  
8 liability may have been based on facts unavailable to USF during this time period, and  
9 may involve a factual determination minimizing the relevance of USF’s retained expert.

10 Smith’s also argues that USF acted in bad faith when it failed to communicate to  
11 Smith’s the Offer made by Ms. Bell’s attorney during the ten-day acceptance period.  
12 See *Miller*, 212 P.3d at 325 (“A primary insurer’s right and duty to defend attaches when  
13 the insured tenders defense of the lawsuit to the insurer and carries with it the duty to  
14 communicate to the insured any reasonable settlement offer that could affect the  
15 insured’s interest.”). Failure to communicate a settlement offer may, on its own, give rise  
16 to an insurance bad faith claim. *Id.* at 327 (holding that a “failure-to-inform theory is a  
17 viable basis for bad faith by itself”). As liability on a failure-to-inform theory depends on  
18 weighing a number of different fact-specific factors, see *id.* at 326-27 (surveying law from  
19 different jurisdictions, and ultimately submitting issue to jury), the jury is best positioned  
20 to determine whether USF’s failure to inform constituted bad faith on its own.

21 Lastly, USF refused Smith’s’ various demands for independent counsel in the face  
22 of a conspicuous conflict between itself and Smith’s over the Bell litigation. No dispute of  
23 fact exists over whether or not a denial of independent counsel occurred, or whether  
24 such a denial was reasonable or not. In its letters to Smith’s, USF made clear that its  
25 refusal to provide independent counsel was based on the Policy’s term that prohibits the  
26 insured from selecting its own counsel. (See dkt. nos. 64-L (“Smith’s is bound by the  
27 terms and conditions of this policy, which does not permit the insured to select defense  
28 counsel of their choice.”) and 84-M.) To the extent that this term governed USF’s



obligations to Smith's, it cannot swallow the principle that the insurer's duty to defend its insured recognizes its obligation to pay for independent counsel when a conflict emerges. See *Hansen*, 2012 WL 6205722, at \*8-9 (relying on *Nev. Yellow Cab Corp. v. Eighth Judicial Distr. Court ex rel. Cnty. of Clark*, 152 P.3d 737, 741-42 (Nev. 2007)). Whether failure to adhere to this obligation constituted bad faith, however, is a question best poised for the jury. If USF was merely ignorant of this requirement, or acted negligently in failing to adhere to it, no bad faith existed. However, if USF's conduct in denying Smith's independent counsel was the result of intentional bad faith conduct, USF may be liable irrespective of its other conduct.

In sum, material questions of fact remain as to whether USF failed to "adequately protect the insured's interest," and as a result is liable for a bad faith insurance violation. See *Miller*, 212 P.3d at 326 (stating that insured must at minimum "equally consider the insured's interests and its own"). Given the fact-intensive nature of such a determination, the Court denies both parties' requests for summary judgment on Smith's bad faith counterclaim.

### **C. Equitable estoppel**

#### **1. Legal Standard**

The doctrine of equitable estoppel "provides that a person may not deny the existence of a state of facts if he intentionally led another to believe a particular circumstance to be true and to rely upon such belief to his detriment." *Strong v. Cnty. of Santa Cruz*, 543 P.2d 264, 266 (Cal. 1975) cited with approval in *Chequer, Inc. v. Painters and Decorators Joint Comm., Inc.*, 655 P.2d 996, 998-99 (Nev. 1982)). Unlike many jurisdictions, Nevada does not limit equitable estoppel to an affirmative defense. See *Mahban v. MGM Grand Hotels, Inc.*, 691 P.2d 421, 424 (Nev. 1984). In order to establish equitable estoppel, "(1) the party to be estopped must be apprised of the true facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting estoppel has the right to believe it was so intended; (3) the party asserting the estoppel must be ignorant of the true state of facts; (4) he must have relied



1 to his detriment on the conduct of the party to be estopped.” *In re Harrison Living Trust*,  
 2 112 P.3d 1058, 1062 (Nev. 2005).

## 3 **2. Analysis**

4 Smith’s has demonstrated the requirements for its equitable estoppel  
 5 counterclaim against USF. At bottom, USF led Smith’s into believing that it would  
 6 defend and indemnify Smith’s without reservation, and subsequently filed this  
 7 declaratory action seeking a court proclamation that Smith’s was not entitled to this  
 8 representation. USF argues that it was not apprised of all the facts in this case, since it  
 9 believed that J&I had accepted Smith’s tender. But as explained above, whether or not  
 10 J&I accepted Smith’s tender is irrelevant to whether USF entered into a contract that  
 11 obligated it to represent Smith’s. Put differently, the “true state of facts” that USF must  
 12 be ignorant of do not include J&I’s formal acceptance of Smith’s tender. Accordingly,  
 13 Smith’s succeeds as a matter of law on its equitable estoppel counterclaim.<sup>4</sup>

## 14 **D. Affirmative defenses**

15 USF asserts two affirmative defenses in its Opposition to Smith’s Motion for  
 16 Summary Judgment: unclean hands and equitable estoppel.

### 17 **1. Unclean hands**

18 “The unclean hands doctrine generally ‘bars a party from receiving equitable relief  
 19 because of that party’s own inequitable conduct.” *Las Vegas Fetish & Fantasy*  
 20 *Halloween Ball, Inc. v. Ahern Rentals, Inc.*, 182 P.3d 764, 766 (Nev. 2008) (quoting  
 21 *Food Lion, Inc. v. S.L. Nusbaum Ins. Agency, Inc.*, 202 F.3d 223, 228 (4th Cir. 2000)).  
 22 USF asserts this defense to all claims.<sup>5</sup> In particular, USF argues that the disclosure of

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23 <sup>4</sup>Success on this counterclaim does not entitle Smith’s to any remedies beyond  
 24 that which it seeks in its insurance bad faith claim. While Smith’s styled its invocation of  
 25 equitable estoppel as a counterclaim, it invokes estoppel as a quasi-defense to USF’s  
 declaratory judgment request. See *Mahban*, 691 P.2d at 424.

26 <sup>5</sup>While it may be likely that an unclean hands defense can be invoked even when  
 27 only a remedy at law is sought despite the doctrine’s historical roots in courts of equity,  
 28 the Court’s review of Nevada law did not reveal any decision addressing this issue.  
 Other states have extended the doctrine to apply to remedies at law. See, e.g., *Camp v.*  
*Jeffer, Mangels, Butler & Marmaro*, 65 Cal. App. 4th 620, 638 (Cal. Ct. App. 1995) (“In  
 (fn. cont...)”)

1 confidential attorney reports by Smith's in pursuit of its counterclaim bars it from seeking  
 2 recovery for a bad faith insurance claim. The Court agrees that the disclosure of the  
 3 reports was improper. Smith's responds to the charge by arguing that USF's misconduct  
 4 was the driving force behind the challenged disclosures, and that the compulsory  
 5 counterclaim rule mandated the disclosures. Both arguments fail.

6 First, a party asserting an unclean hands defense necessarily stands accused of  
 7 some illegality. It is no retort to disclaim one's unclean hands by pointing to the original  
 8 illegality as the cause for one's own misconduct. Indeed, the doctrine of unclean hands  
 9 is an affirmative defense levied regardless of whether the asserting party is liable for the  
 10 underlying violation.

11 Second, the question of whether the Federal Rules of Civil Procedure compelled  
 12 Smith's to file a counterclaim is independent of whether Smith's ought to have disclosed  
 13 potentially confidential information during the pendency of the Bell litigation. Here, the  
 14 insurer (USF) and the insured (Smith's) are joint clients represented by retained counsel  
 15 (John Shannon). See *Nev. Yellow Cab Corp.*, 152 P.3d at 741-42 (adopting majority  
 16 rule that "counsel represents both the insured and the insurer"). "Each of the joint clients  
 17 holds the privilege protecting their confidential communications with the attorney; one  
 18 client may not waive the privilege without the consent of the other." *Roush v. Seagate*  
 19 *Tech., LLC*, 150 Cal. App. 4th 210, 223 (Cal. Ct. App. 2007); see also *Am. Mut. Liab.*  
 20 *Ins. Co. v. Superior Court*, 38 Cal. App. 3d 579, 590-96 (Cal. Ct. App. 1974) (holding that  
 21 when one client has waived the privilege, the joint clients' attorney cannot waive that  
 22 privilege for the other). While the documents may not be privileged as between Smith's  
 23 and USF, see *Glacier Gen. Assurance Co. v. Superior Court*, 95 Cal. App. 3d 836, 842

24  
 25 (fn. cont.)

26 California, the doctrine of unclean hands may apply to legal as well as equitable claims  
 27 and to both tort and contract remedies."); *Maldonado v. Ford Motor Co.*, 719 N.W. 2d  
 28 809, 818 (Mich. 2006) ("The authority to dismiss a lawsuit for litigant misconduct is a  
 creature of the 'clean hands doctrine' and, despite its origins, is applicable to both  
 equitable and legal damage claims."). As the parties have not briefed the issue, the  
 Court declines to entertain the question until such a determination becomes necessary.

1 (1979) (holding that an insurer cannot invoke attorney-client privilege to shield the  
2 insured from introducing otherwise protected information central to the insured's bad  
3 faith claim against the insurer), that privilege remains as to strangers to the attorney-  
4 client relationship. See, e.g., *Nowell v. Superior Court for Los Angeles Cnty.*, 223 Cal.  
5 App. 2d 652, 657 n.4 (1963) ("Where two or more persons engage an attorney to  
6 represent all of them, the privilege is waived as between the parties, but it remains as to  
7 strangers."). Consequently, Smith's was under an obligation to maintain the  
8 confidentiality of the documents from strangers. Its failure to do so jeopardized USF's  
9 ability to represent Smith's' interest in settlement negotiations.

10 Conspicuously absent from the parties' briefings was a simple choice available to  
11 Smith's: requesting court leave to disclose the confidential documents under a protective  
12 order. See *Silva v. Fire Ins. Exch.*, 112 F.R.D. 699, 700 (D. Mont. 1986) (holding that  
13 while work product and attorney-client privilege cannot be invoked to the insurance  
14 company's benefit in an insurance bad faith claim, the court can "entertain a motion for  
15 protective order to preclude the dissemination of particular information" upon a  
16 particularized showing of good cause). Smith's failed to seek leave to file under seal  
17 documents it ought to have known would damage USF (and, in turn, Smith's and J&I's)  
18 position in the Bell litigation.

19 The remaining question before the Court in evaluating the unclean hands defense  
20 is the seriousness of Smith's disclosure and the circumstances that led to the filing of the  
21 confidential report without seeking a protective order. This is admittedly a difficult fact  
22 question that the Court is unprepared to resolve on summary judgment. Smith's does  
23 not address USF's contention that the disclosures damaged settlement negotiations in  
24 the Bell litigation, while USF argues that Ms. Bell's counsel utilized the confidential  
25 reports disclosed in this suit to its advantage during continued settlement negotiations.  
26 In a January 2011 letter to counsel for Smith's and J&I, Ms. Bell's counsel referred to Mr.  
27 Shannon's confidential valuation of the Bell litigation at between \$6 and \$10 million, and  
28 indicated that he would entertain settlement offers only if they began at \$3 million. (Dkt.

1 no. 89-D.) This valuation traces back to a letter Mr. Busby wrote to Sally Rock on May 7,  
2 2010, where he communicated his frustration over USF's \$100,000 settlement offer in  
3 light of Mr. Shannon's status report where, according to Mr. Busby, "Mr. Shannon gave  
4 the opinion that the exposure in this case is between \$6 and \$10 million." (Dkt. no. 6-L.)  
5 This letter was filed by Smith's as one of many exhibits appended to its Answer and  
6 Counterclaims. (See dkt. no. 6.) In addition, USF attorney Pamela McKay testified that  
7 Mr. Bell's counsel acknowledged reading the disclosed letter. (Dkt. no. 89-2 at ¶ 7.) It is  
8 unclear from this evidence what impact the disclosure of Mr. Shannon's evaluation had  
9 on 2011 settlement discussions. If the settlement amount ultimately decided on between  
10 the parties in the Bell litigation was likely to be approximately \$3 million regardless of  
11 Smith's' disclosure, this factor of the unclean hands defense would prove fatal to USF.  
12 Moreover, it is not clear to the Court from the evidence presented what benefit, if any,  
13 Smith's gained from disclosing the information in the report. USF has not demonstrated  
14 as a matter of law that Smith's seeks judgment with unclean hands, nor has Smith's  
15 carried its burden in refuting USF's affirmative defense. The Court denies both parties'  
16 request for summary judgment on this issue.

## 17 **2. Equitable estoppel**

18 USF also asserts an equitable estoppel defense to the counterclaims, arguing that  
19 it would not have entertained the representation of Smith's had it known that J&I had not  
20 formally accepted Smith's' tender of defense. This defense fails for the reasons  
21 described above. Pursuant to the Policy, USF was required to defend and indemnify J&I  
22 for suits against Smith's covered by the Maintenance Agreement. J&I's duty to defend  
23 and indemnify Smith's was also not discretionary.

## 24 **E. Punitive damages**

25 Both parties seek summary judgment on Smith's request for punitive damages in  
26 its counterclaims.

27 While punitive damages are generally not rewarded in breach of contract claims,  
28 Nevada law provides punitive damages in cases alleging involving an insurer's breach of

1 the implied covenant of good faith and fair dealing. See *Great Am. Ins. Co. v. Gen.*  
2 *Builders, Inc.*, 934 P.2d 257, 263 (Nev. 1997). NRS § 42.005(1) provides for punitive  
3 damages “in an action for the breach of an obligation not arising from contract, where it  
4 is proven by clear and convincing evidence that the defendant has been guilty of  
5 oppression, fraud or malice, express or implied . . .” Oppression is in turn defined as “a  
6 conscious disregard for the rights of others which constitute[s] an act of subjecting  
7 plaintiffs to cruel and unjust hardship.” *Ainsworth*, 763 P.2d at 675. Nevada law defines  
8 malice as “conduct which is intended to injure a person or despicable conduct which is  
9 engaged in with a conscious disregard of the rights or safety of others.” *Countrywide*  
10 *Home Loans, Inc. v. Thitchener*, 192 P.3d 243, 252 (Nev. 2008) (citing  
11 NRS § 42.005(3)). Fraud is defined as “an intentional misrepresentation, deception or  
12 concealment of a material fact known to the person with the intent to deprive another  
13 person of his or her rights or property or to otherwise injure another person.” *Id.*  
14 at § 42.005(2).

15 USF argues that its conduct during the course of the representation was  
16 justifiable, including its decision not to settle the litigation within policy limits. It argues  
17 that its failure to settle the litigation during the 2009 mediation was due to Ms. Bell’s offer  
18 that exceeded USF’s policy limits, an offer it argues was unreasonable at the time.  
19 Smith’s counters by pointing to USF’s general inadequacy in its representation, including  
20 its decision not to appoint independent counsel when a conflict arose between J&I and  
21 Smith’s, and its decision not to settle within policy limits when it knew that J&I was 100%  
22 liable for Bell’s injuries. For the same reason underlying the Court’s decision not to  
23 award judgment to either party on Smith’s’ bad faith counterclaim, a question of fact  
24 exists as to whether USF acted in an oppressive, malicious, or fraudulent way. It is up to  
25 the jury to decide whether, in light of the facts available to USF during the relevant  
26 periods, USF acted with sufficient malice to be liable for punitive damages. Accordingly,  
27 both parties’ summary judgment requests with respect to punitive damages are denied.

28 ///

**V. CONCLUSION**

In summary, the record demonstrates USF owed a contractual duty to defend and indemnify Smith's in the underlying Bell litigation. J&I was required to defend and indemnify Smith's in the underlying action, and Smith's qualified as an insured under the Policy. Consequently, USF was obligated to defend and indemnify Smith's in the Bell's litigation. This duty included an obligation to retain, at its expense, independent counsel for Smith's when a conflict of interest arose.


However, a genuine issue of material fact exists as to whether USF acted in bad faith and whether Smith's engaged in unclean hands by filing the confidential attorney report. The question of whether punitive damages should be awarded in light of USF's misconduct is also one for the jury to decide, as material questions of fact preclude a ruling as a matter of law.

Based on the foregoing, IT IS HEREBY ORDERED that Plaintiff USF Insurance Company's Motion for Summary Judgment (dkt. no. 61) is DENIED.

IT IS FURTHER ORDERED that USF's Motion for Partial Summary Judgment (dkt. no. 63) is DENIED.

IT IS FURTHER ORDERED that Smith's Food and Drug Center, Inc.'s Motion for Summary Judgment (dkt. no. 84) is GRANTED in part and DENIED in part, as outlined herein.

DATED THIS 4<sup>th</sup> day of February 2013.

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MIRANDA M. DU  
UNITED STATES DISTRICT JUDGE